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IN THE

Supreme Court of the United States

OCTOBER TERM, 1960

No. 23

KARL F. KNETSCH and EVA FAY KNETSCH,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

BRIEF OF AMICI CURIAE

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BRIEF OF AMICI CURIAE

I. Interest of the Amici Curiae

This brief is submitted, with the written consent of both sides, in support of the position of the Petitioners by Richard H. Appert, Esq., and Converse Murdoch, Esq., jointly, as *amici curiae*. Messrs. Appert and Murdoch are, respectively, counsel for the petitioners in the cases of *Weller* v. *Commissioner*, 270 F. 2d 294 (3d Cir. 1959), petition for cert. filed (No. 574, 1959 Term; renumbered No. 20, 1960 Term), and *Emmons* v. *Commissioner*, 270 F. 2d 294 (3d Cir. 1959); petition for cert. filed (No. 573, 1959 Term; renumbered No. 19, 1960 Term), which cases involve legal issues similar to those in the present case. This Court has not acted with respect to the petitions for certiorari in the *Weller* and *Emmons* cases.

II. Summary of the Argument

For a period of at least five years prior to 1954, the Internal Revenue Service in a series of rulings, held that interest paid under circumstances present in this case

was deductible for income tax purposes. Many persons including Messrs. Knetsch, Weller and Emmons relied on these rulings. Congress recognized the efficacy of these rulings in amending the interest section in 1954 to prohibit such interest deductions—*prospectively*.

In 1954, the Treasury Department reversed its position and ruled that interest incurred in connection with such plans was not deductible. As to the limited group of persons who had rulings addressed to them, officials of the Internal Revenue Service have indicated that the new position would not be applied retroactively; as to certain others, it was applied retroactively.

The Commissioner is abusing his discretionary authority to limit the retroactive effects of rulings. The position established by the pre-1954 rulings was relied on by many taxpayers who entered into commitments on the basis of such position. Also, the Commissioner is discriminating between persons who did not happen to receive letter rulings addressed to them and those who did.

The taxpayer's transactions were real and legally binding. The only long-range tax significance of the plan utilized in this case was to defer income taxes or to secure eventual capital gains through present ordinary income tax deductions. If there is any tax fault in the plan, it lies in the tax statutes and not with the taxpayer. If the taxpayer's technique in deferring or somewhat reducing his income taxes is not in keeping with a sound fiscal policy, it is the function, not of the Commissioner or of the Courts, but of Congress to prohibit it (as was done in the 1954 Code—prospectively).

All the known evidence and authorities point to the conclusion Congress intended interest such as that involved in this case to be deductible provided the related annuity contract was purchased before March 2, 1954—as this one was.

III. The Argument

A. This Court should nullify the Commissioner's arbitrary, capricious and discriminatory action in retroactively reversing, as to the taxpayer, a position widely publicized through official rulings, and in continuing to allow interest deductions under similar circumstances in the cases of other taxpayers.

The *Knetsch* case, like the *Weller* and *Emmons* cases, involves a legal issue which is common to the many cases involving the deduction of interest incurred in connection with the purchase on credit of an annuity contract. This issue is whether the Commissioner may retroactively reverse his previously announced position of allowing an interest deduction under the circumstances present in these cases after the taxpayers have entered into transactions in reliance on his announced position and while he continues to adhere to his original position with respect to certain taxpayers similarly situated.

In reply to requests for rulings submitted by, or on behalf of, individuals contemplating a program of borrowing in connection with the purchase of annuity contracts, the Commissioner issued a great number of formal letter rulings categorically stating that interest paid on loans such as those involved in the *Knetsch, Emmons, Weller* and other similar cases was deductible under section 23(b) of the Internal Revenue Code of 1939, 53 Stat. 12 (1939), 26 U.S.C.A. (I.R.C. 1939) § 23(b) (1955). In the *Weller* case the record contains copies of eight such rulings issued to different persons and involving the annuity contracts of several different insurance companies.[2] *Weller* v. *Commissioner, supra*, Petitioners' Exs. 6-13; R. 48a-67a, 40a. The earliest of such rulings is dated November 21, 1947 and the latest is dated November 6, 1952. Thus they reflect a consistent position of the Commissioner spanning a period of five years. During

those years, there was wide circulation of copies of such rulings and the tax features of the plans ruled upon by the Commissioner were widely publicized. For example, as noted by the District Court in its findings of fact in the *Knetsch* case, Mr. Knetsch had been solicited by direct mail advertising from the Sam Houston Life Insurance Company. *Knetsch* v. *United States*, 58-2 U. S. Tax Cas. ¶9935 (S.D. Calif. 1958) (finding of fact No. IV). The District Court also found that Sam Houston had regularly advertised the tax benefits of the plan in financial newspapers. *Ibid.*

As a result of the widely publicized favorable position of the Commissioner, evidenced by his official rulings, many persons purchased annuity contracts, borrowed money to pay the premiums, paid interest on the loans and deducted the interest on their income tax returns. Certain of these persons had ruling letters addressed to them. Other taxpayers saw and relied upon the very same rulings, copies of which had been shown them by the selling agents. These rulings flatly stated the official position of the Commissioner to be that an interest deduction was permitted in circumstances similar or even identical with those here present.

The Internal Revenue Service in March of 1954 published in the Internal Revenue Bulletin a ruling with respect to this type of case, *Rev. Rul. 54-94*, 1954-1 Cum. Bull. 53. In that ruling, the Service described a loan transaction substantially identical with that involved in this and similar cases and in the many prior rulings referred to above. However, in the March 1954 ruling the Commissioner stated that interest paid on such loans was not deductible. No statement was made in the March 1954 ruling as to its effective date. However, high ranking Internal Revenue Service officials later stated to a Ways and Means subcommittee that as to taxpayers who

had letter rulings addressed to them, the March 1954 ruling would not be applied retroactively to the extent that those taxpayers had relied on the letter rulings to their detriment. Subcommittee on Internal Revenue Taxation of the House Committee on Ways and Means, Progress Report, April 22, 1957, pp. 191-192.[1] The pendency of this and similar cases shows that at least as to some taxpayers who did not receive letter rulings with their names on them, the Commissioner has proceeded to give fully retroactive effect to his changed position as set forth in his March 1954 ruling. This was despite the fact that these taxpayers had read and relied upon the very same official rulings which the Commissioner regards as protecting the taxpayers whose names appear thereon and despite the fact that the number of rulings clearly evidenced an established administrative position upon which the taxpayers were justified in relying.

This Court has indicated that in two situations the Commissioner may not revoke an administrative pronouncement with retroactive effect.

The first situation is represented by the cases of *Helvering v. R. J. Reynolds Tobacco Co.*, 306 U. S. 110 (1939) and *Provost* v. *United States*, 269 U. S. 443, 458 (1926). In those cases, this Court established the principle that the Treasury Department may not retroactively change a prior official construction of an internal revenue statute which has survived reenactment of such statute. The rationale underlying this principle is that by reenacting the law without material change, Congress has recognized the administrative construction and has indicated an intention to continue that construction in force. The present case presents a fortiori situation for applying that reasoning.

1. This policy was again acknowledged by the Commissioner in his reply brief in the Tax Court in Carl E. Weller, 31 T.C. 33 (1958), at p. 9.

When the Internal Revenue Code of 1954 was in the process of enactment, Congress was fully aware of the interest deduction problem created by plans exactly similar to that present in this case. In its report on H.R. 8300 (which became the Internal Revenue Code of 1954) the Ways and Means Committee stated as follows on the very plan and problem presented by this case:

> "Existing law does not extend the denial of the interest deduction to indebtedness incurred to purchase single-premium annuity contracts. It has come to your committee's attention that a few insurance companies have promoted a plan for selling annuity contracts based on the tax advantage derived from omission of annuities from the treatment accorded single-premium life-insurance or endowment contracts. The annuity is sold for a nominal cash payment with a loan to cover the balance of the single-premium cost of the annuity. Interest on the loan (which may be a nonrecourse loan) is then taken as a deduction annually by the purchaser with a resulting tax saving that reduces the real interest below the increment in value produced by the annuity.
>
> "Your committee's bill will deny an interest deduction in such cases but only as to annuities purchased after March 1, 1954." H. R. Rep. No. 1337, 83d Cong., 2d Sess. 31 (1954).

To the same effect, see the Senate Finance Committee report. S. Rep. No. 1622, 83d Cong., 2d Sess. 38 (1954). Since, at the time of enactment of the Internal Revenue Code of 1954, there had been no judicial decisions whatsoever with respect to the interest deduction in these annuity loan cases, it is obvious that the congressional reports were basing their statements of existing law upon the well-known and well-established position of the Commissioner as evidenced by his long series of favorable rulings

It should be noted that the effective date provision in the 1954 Code section covering this type of plan goes beyond the usual effective date provision, in an effort to protect taxpayers from the hardships resulting in adverse changes in the tax laws. It would have been a very ordinary thing for Congress to have said in changing the rules in this area that no deduction should be allowed for any interest of this type *paid* after March 1, 1954. However, Congress apparently felt that the existence of the well-publicized favorable position of the Commissioner which had induced taxpayers to purchase annuities in reliance thereon required the extraordinary step of denying an interest deduction *only in the case of contracts purchased after March 1, 1954.* Thus Congress stated that where a taxpayer had signed up in a plan such as that here present prior to March 2, 1954 he would be permitted a deduction for interest paid both before and after March 1, 1954.

Even if it be conceded that the pre-1954 law might be construed as not permitting an interest deduction under the circumstances of this case, it is clear that Congress recognized in this case, as did this Court in the *Reynolds* and *Provost* cases, an existing administrative construction of the tax laws which must be followed. The only difference between the situation here and that in the *Reynolds* and *Provost* cases is that in the present case the prior law was changed, instead of being reenacted by Congress; but it was changed in prospective terms—thus indicating, at the very least, a congressional intention that the prior administrative interpretation be continued for existing annuity contracts. By expressly excluding existing annuity contracts from the provisions of the new law, Congress, in effect, reenacted the 1939 Code provisions as to such contracts and indicated approval of the Commissioner's announced position of allowing the interest

deduction under the circumstances of this case. Since the Commissioner has failed to respect this congressional intention, it is left to this court to see that it is carried out.

The Commissioner may argue that the present case differs from the *Reynolds* case in that the former involves letter rulings of the Commissioner while the latter involved a Treasury Regulation. Although there are obvious distinctions between a regulation and such rulings, they are not significant for present purposes for several reasons:

1. A large number of such rulings were issued with respect to the present type of case.[1] In other words, this is not the situation in which a single minor official of the Bureau of Internal Revenue gave a snap judgment opinion as to the position of the government in response to an offhand question. Rather this is a case in which persons in high positions in the national office of the Bureau of Internal Revenue stated in writing the Commissioner's position on the effect of the law in response to formal requests for such rulings submitted in accordance with the Treasury's regulations.

2. The rulings were issued continually over a period of many years.[2]

3. The rulings were widely publicized.[3]

4. Many purchasers of single-premium annuity contracts were shown copies of one or more rulings and they relied thereon.[2] In fact it is unrealistic to suppose that a taxpayer who was not a lawyer specializing in tax law

2. See Carl F. Weller, 31 T.C. 33 (1958), aff'd 270 F. 2d 294 (3d Cir. 1959); W. Stuart Emmons, 31 T.C. 26 (1958), aff'd 270 F. 2d 294 (3d Cir. 1959); Bond v. United States, 57-1 U. S. Tax Cas. ¶9680 (S.D. Tex. 1957) aff'd 258 F. 2d 577 (5th Cir. 1958).

3. See Subcommittee on Internal Revenue Taxation of the House Committee on Ways and Means Progress Report, April 22, 1957, pp. 191-192.

would have greater respect for (or even access to) a Treasury Regulation than he would for a letter signed by or for the nation's chief tax officer and covering explicitly the exact problem involved in the plan he was about to adopt.

5. Congress was as fully aware of the administrative position as it would have been had such position been embodied in a Treasury Regulation.[4]

Under the circumstances, the Commissioner's rulings were at least as effective in evidencing his position and in inducing reliance thereon as a Treasury Regulation would have been. In *Connecticut Railway and Lighting Co.* v. *United States*, 135 Ct. Cl. 650, 142 F. Supp. 907 (1956), the Court of Claims gave effect to an administrative practice of the Bureau of Internal Revenue publicized only in a brief filed by the government in a case before this Court. There the Court of Claims aptly referred to such administrative practice as "the law in action."

The same court which decided the present case, in a decision involving the National Labor Relations Board, gave effect to a well-known policy of that agency, although it had not previously been applied to the particular respondent. *NLRB* v. *Guy F. Atkinson Co.*, 195 F. 2d 141, 149 (9th Cir. 1952), where the court stated:

> "The prior policy of not assuming jurisdiction in matters affecting the construction industry was to (sic) fixed and so notorious that we cannot perceive that respondent was any less taken by surprise than it would have been had the prior ruling occurred in a matter concerning this very respondent."

The fact that the Commissioner's rulings in the area were not printed in the Internal Revenue Bulletin does

[4] See discussion, p. 6, *supra*.

not militate against their efficacy as official statements of the government's position. It should be noted that a determination not to print a ruling in the Internal Revenue Bulletin does not mean that the Internal Revenue Service is in doubt about the legal principles involved or that the ruling does not represent the official position of the Service. *Rev. Rul. 2*, 1953-1 Cum. Bull. 484, as modified by *Rev. Rul. 212*, 1953-2 Cum. Bull. 449, as modified by *Rev. Proc. 55-1*, 1955-2 Cum. Bull. 897. In fact, one of the classes of rulings not reproduced in the Internal Revenue Bulletin includes those which are considered to involve questions specifically and clearly covered by statute or regulations. See *Rev. Rul. 2, supra*, ¶ 4(a). Presumably the failure of the Bureau of Internal Revenue to print its pre-March 1954 rulings in the Internal Revenue Bulletin was attributable to the fact that someone in authority believed that the position of the government was clearly in accord with the applicable statute or regulations.

The second situation in which this Court has indicated that it would be improper for the Commissioner to revoke a ruling retroactively is presented in *Automobile Club v. Commissioner*, 353 U. S. 180 (1957). There this Court approved a retroactive reversal of a ruling to a particular automobile club where it was shown that all automobile clubs were being treated in the same manner pursuant to a previously published ruling of general application. The ruling was revoked only with respect to the years following the publication of the generally applicable published ruling. This retroactive action by the Commissioner was held by the Court not to have been an abuse of his discretion under section 3791(b) of the Internal Revenue Code of 1939[5] (now § 7805(b) of the Internal Revenue Code of 1954[6]) to prescribe the extent to which a ruling

5. 53 Stat. 467 (1939), 26 U.S.C.A. (I.R.C. 1939) §3791(b) (1955).
6. 68A Stat. 917 (1954), 26 U.S.C. §7805(b) (1958 ed.).

should be applied with retroactive effect. This Court made it clear, however, that the Commissioner's action was approved only because his retroactive action did not have inequitable results, but indicated that a retroactive action which did have inequitable results would be disapproved.

In the present case the inequity is twofold. First, the Commissioner is denying the interest deduction for tax years prior to his published change in position in 1954. Secondly, the Commissioner is applying the new ruling retroactively only to those taxpayers who did not obtain their own private rulings.

The application of the 1954 ruling to pre-1954 tax years is particularly inequitable in a case such as the present one, since the taxpayer would probably not have entered into the transaction if he had not been reassured by rulings which were favorable to the taxpayers and which indicated no question would be raisod about this in the audit of his returns. Thus, the present taxpayers are being required to pay taxes and substantial amounts of interest arising out of transactions which they never would have consummated except for the fact that the Commissioner had placed his stamp of approval upon the transactions. In this respect the present type of case is quite different from the *Automobile Club* case in which the club would undoubtedly have continued to operate even if it knew the Commissione. might reverse his prior ruling of exemption.

This basic unfairness is compounded by the fact that the government has said that those taxpayers who obtained rulings are protected against retroactive application of the 1954 ruling, at least to the extent of the detriment suffered in reliance upon the private rulings. The government is apparently going so far as to grant immunity from pro-government court decisions to these fortunate taxpayers who have letters with their names at the top.

This means that if this Court approves the Commissioner's position in this case and the Commissioner persists in his announced policy of allowing deductions for the limited group of taxpayers who possess ruling letters bearing their names as addressees, that select group will receive a tax deduction for interest paid both before and after March 1, 1954 and for many years after this Court announces its decision in this case. Other taxpayers such as Messrs. Knetsch, Weller and Emmons will be subjected to the penalties attendant on complete disallowance of interest deductions for amounts paid at the very time the Commissioner was issuing rulings approving such deductions.

Such a result is monstrous. It should not be countenanced by this Court. The presence or absence of a particular person's name on what is concededly a written statement of the position of the Commissioner as to the applicability of an internal revenue statute written to cover all taxpayers is not of sufficient significance to warrant such a harsh, incongruous and unjust result as that for which the Commissioner contends.

There is no consideration of administrative expediency which can justify such a sacrifice of basic principles of even handed justice, under laws of general application.

This is not a situation in which one taxpayer, after the event, hears about and seeks the protection of another taxpayer's private ruling. Rather, it is a situation in which, prior to the event, taxpayers knew of and relied upon a well-established position of the Commissioner evidenced by formal written rulings. Should these taxpayers be penalized for failing to take the meaningless step of obtaining a letter addressed to them and repeating what had already been said clearly to other taxpayers? It was obvious that such rulings were being issued to others at the same time with respect to the same plans. No

sensible policy (administrative or otherwise) is served by a rule which says that no matter how many taxpayers have gotten rulings on a point and despite the fact such rulings are widely publicized, no person may rely on such ruling unless he submits a request for an identical ruling with his name on it. The result of such a policy will be needlessly to clog the ruling channels of the Internal Revenue Service with *pro forma* requests for more and more rulings on points on which the Commissioner's position is clear and well known.

In his concurring opinion in *United States* v. *Kaiser*, 363 U. S. 299, 308 (1960), Justice Frankfurter suggested that:

> "The Commissioner cannot tax one and not tax another without some rational basis for the difference. And so, assuming the correctness of the principle of 'equality', it can be an independent ground of decision that the Commissioner has been inconsistent, without much concern for whether we should hold as an original matter that the position the Commissioner now seeks to sustain is wrong."

Justice Frankfurter then submitted that the proper test is, "Is there any rational basis for the prior rulings which does not apply to the present case?" It is perfectly clear that in the present case the prior rulings are directly in point and that the bases of those rulings are applicable to the present case.

The Third Circuit, in the *Weller* case and *Emmons* case approved the government's actions in this area on the ground that there was no discrimination since all taxpayers *without rulings* are being treated equally. This seems the equivalent of saying that there is no discrimination against negroes if all negroes are treated in the same manner—unfair as the treatment may be.

Such reasoning runs counter to what this Court has consistently required in the administration of our laws—whether federal or state. Over seventy years ago this Court in determining whether there was discrimination for purposes of applying the equal protection clause of the United States Constitution, struck down an ordinance regulating laundries which was applied in fact only to Chinese. *Yick Wo* v. *Hopkins*, 118 U. S. 356 (1886). There this Court said:

> "Though the law itself be fair on its face and impartial in appearance, yet, if it is applied and administered by public authority with an evil eye and an unequal hand, so as practically to make unjust and illegal discriminations between persons in similar circumstances, material to their rights, the denial of equal justice is still within the prohibition of the Constitution." 118 U. S. at 373-374.

That principle of equal application of law has been applied in the federal tax field within recent months by two lower courts. In *Exchange Parts Company* v. *United States*, CCH Fed. Excise Tax Rep. ¶ 15,304 (Ct. Cl., June 8, 1960) the Court of Claims held for the taxpayer solely on the basis that the Commissioner "made his ruling nonretroactive as to certain taxpayers and retroactive as to others, including the plaintiff." The court condemned the Commissioner's action in discriminating between those taxpayers who had already paid their taxes when the revised ruling was issued and those who had not. Again, in *City Loan and Sav. Co.* v. *United States*, 177 F. Supp. 843, 851 (N.D. Ohio 1959), the court granted a tax refund, saying:

> "[The Commissioner's] action in making an individual, retroactive and discriminatory application of such change of position to taxpayer, while allow-

ing borrowed capital treatment to like funds of The Economy Savings and Loan Company which was identically organized, supervised and operated, constituted inequitable conduct by the Commissioner, if not an unlawful abuse of discretion within the meaning of Section 7805(b) of the Internal Revenue Code of 1954, 26 U.S.C.A. Sec. 7805(b)."

In the circumstances of the present case, the discrimination against the taxpayer based merely on his failure to obtain a ruling with his name typed on it when such rulings were available for the asking is as improper as the actions of the Commissioner in the *Exchange Parts* and *City Loan* cases. Elementary concepts of fairness in the functioning of executive departments of the government demand that the Commissioner not be permitted to apply his 1954 ruling retroactively to any taxpayer. Certainly he should not be permitted to apply his changed position with respect to some taxpayers and not as to others. This concept of equality, above all others, was chosen to greet all who enter the doors of this Court—"Equal Justice Under Law."

B. The plan involved in this case is not a tax avoidance device.

Those courts which have decided against the taxpayers on the issue posed by this case have relied primarily on what they believe to be a lack of economic substance to the transactions involved in these cases. The courts appear to be disturbed about what at first blush seems to be a purchase of interest deductions.

The taxpayers entered into legally enforcible contracts with bona fide insurance companies. None of the courts below have questioned this. Having purchased annuity contracts on credit, the taxpayers incurred interest

charges. Like millions of other taxpayers who incur interest charges (whether in connection with income producing activities or in connection with purely personal matters such as the purchase of a home encumbered with a mortgage loan) these taxpayers expected that the net cost of such interest charges would be reduced by the fact that they could deduct such interest in computing their taxable income. Whether the cost of non-business borrowing should, in effect, be reduced by an allowable income tax deduction is a policy matter open for debate. The fact that the statute applicable in this case permits such reduction is not open to debate.

The government has led the lower courts to believe that the plans such as that involved in this case are by their nature tax avoidance devices and that they are therefore suspect and to be condemned.

Looked at from the government's point of view these plans are mere tax deferral plans, and, at the very worst, plans which result in trading ordinary income deductions for later capital gains taxation. The Tax Court (which decided the *Emmons* and *Weller* cases for the government) has held that such trading is not condemned by the internal revenue laws. *L. Lee Stanton*, 34 T.C. No. 1 (April 7, 1960).

If an annuity policy purchased on the plan utilized by the taxpayer in this and the *Emmons* and *Weller* cases is held to maturity or is surrendered, the taxpayer will be required to report as ordinary income (and pay income tax thereon) what in effect amounts to the same dollars he deducted earlier as interest payments. See Treas. Reg. Sec. 1.72-11(d) (1956). Thus the plan results not in "tax avoidance" but in "tax deferral."

If instead of holding the annuity contracts purchased on credit until maturity and then receiving their proceeds

in periodic payments, or surrendering them, the taxpayers in these cases sell their policies, they will still have taxable gain. From the taxpayers' points of view this will hopefully be capital gain. However, there is some doubt that even that hope can now be achieved. *Commissioner* v. *Phillips*, 275 F. 2d 33 (4th Cir. 1960); *Arnfeld* v. *United States*, 163 F. Supp. 865 (Ct. Cl. 1958), cert. denied, 359 U. S. 943 (1959).

Thus at best (from the taxpayer's point of view) and at worst (from the government's point of view) the plan involved in the instant cases, to the extent it has income tax significance, amounts to no more than a trading of present ordinary income tax deductions for later capital gains.

The tax difficulty which the present taxpayer is facing apparently arises from the fact that he arranged his transaction in such a manner that he would be certain of both the amount of interest and the yearly increment in the value of his investment. For example, if the taxpayer borrowed money at 6% interest to buy securities on which he hoped to receive, but was not sure of receiving, capital gain, he would be permitted to deduct the interest even if he ultimately suffered a capital loss. Thus, he has been denied the application of the clear wording of the interest deduction section in the 1939 Code not really because of any lack of economic reality, but because of the certainty of his economic benefit resulting from the assured increment on the policy which, if taxable at long-term capital gain rates, would have made it worthwhile for the taxpayer to purchase the policy on credit.

Judge Moore said, in dissenting from the decision of the Court of Appeals for the Second Circuit in favor of the government on this very issue in *Diggs* v. *Commissioner*, 60-2 U. S. Tax Cas. ¶9584 (2d Cir., July 5, 1960), petition for cert. filed Aug. 20, 1960:

"My difficulty with the decision is that the Commissioner and the Tax Court add together a series of perfectly legal acts and come out with illegality as their sum. To me this is not only bad mathematics but unsound legal reasoning. They arrive at this result because they do not regard the purchase of the annuities as a commercially meaningful transaction; to them it was merely a tax scheme. At the same time, they concede that where interest is paid on true annuity indebtedness, the interest is deductible. Despite the fact that the transaction had been carefully planned under the law to take advantage of permissible deductions, governmental taxing authorities by calling it a "scheme" (a word of evil connotation) assume a paternalistic role to decide whether a taxpayer should, in his particular circumstances, have handled his financial affairs as he did. Such a paternal attitude comes dangerously close to that envisioned (facetiously, I hope) in "1984" (George Orwell)—a date at the time of writing undoubtedly imaginative but now rapidly approaching."

C. The action of the Commissioner in this and similar cases is contrary to the unequivocally expressed intent of Congress.

As demonstrated at pages 6 to 8, *supra*, every bit of evidence and authority available to the taxpayers points to the conclusion that annuity purchase plans just like that involved in this case were called to the attention of the tax law writing committees of Congress. The committees, and eventually both houses of Congress decided to disallow interest deductions for interest payments in connection with these plans if initiated after March 1, 1954. Int. Rev. Code of 1954, §264.[7] The only fair inference to be drawn from the circumstances surrounding the enactment of that section of the law is that

[7] 68A Stat. 77 (1954), 26 U.S.C. §264 (1958 ed.).

Congress intended that interest on loans associated with existing plans such as the present taxpayer's should continue to be allowed, but that interest on loans with respect to new annuity contracts should be disallowed.

In an attempt to answer this point the government in its brief in the *Emmons* case in the Third Circuit said in referring to the congressional committee reports on section 264 of the 1954 Code:

> "The Committee surely had in mind a transaction with *some* economic substance, apart from tax benefits, which might otherwise qualify for interest deductions if an express prohibition were not enacted." *Emmons* v. *Commissioner, supra,* Brief for Respondent, p. 39.

If the government knows of the transaction (other than the very transaction here presented) which the Congress had in mind in enacting the annuity provision in section 264 of the 1954 Code, let it come forward and identify it. Such information, if in existence, is not available to the taxpayers; if it is available to anyone it is available to the government. The Commissioner should not deal with the courts and taxpayers on the basis of innuendo, but rather on the basis of forthright revelations of what, if any, information it has to support its assertion that Congress did not really intend what the statute and committee reports clearly indicate.

Section 264 of the 1954 Code expressly denies the interest deductions in cases such as this. If there were any indication that Congress intended the 1939 Code to be similarly interpreted, or even if there were no statement of congressional intention on this point, it might be that the deduction should be disallowed for years prior to 1954. But, as demonstrated at pages 6 to 8, *supra,*

the legislative history permits no conclusion other tha that the interest deduction should be allowed for suc prior years.

In view of this specific intention expressed by Congres that the deduction be allowed, it is difficult to see hov the lower courts which disallowed the deduction coul rely on the application of the broad, general principl of statutory construction involved in the case of *Gregor* v. *Helvering*, 293 U. S. 465 (1935).

Gregory v. *Helvering* is frequently cited for the prop osition that transactions lacking a business purpose shal be ignored for tax purposes. However, a careful analysi of that decision shows that the fundamental holding i that in construing tax statutes the courts must view them in the light of expressed or apparent congressional inten This Court decided the *Gregory* case as it did becaus it was convinced that in describing corporate reorganiza tions which could be accomplished without present recog nition of gain *Congress intended* to cover bona fid rearrangements with a business purpose. It is error t say that the *Gregory* case requires a decision for th government in his case even if it is believed that th transaction lacked a business purpose. *Gregory* require a decision for the taxpayer if the Court is convinced tha Congress intended an interest deduction under these cir cumstances. Everything points to the conclusion that i did so intend.

The legislative history of the interest deduction indi cates clearly that Congress intended interest to be deduc ible regardless of business purpose. When the Revenue Ac of 1924 was being enacted, the House version restricte the interest deduction to interest paid or incurred i carrying on a trade or business and other interest pai or incurred which, when added to non-business losse exceeded tax-exempt interest received. However, pri

to enactment, the trade or business requirement was eliminated and a deduction was allowed for all interest on indebtedness except on indebtedness incurred or continued to purchase or carry tax-exempt securities. Again, when the Revenue Act of 1926 was pending, the House attempted to restrict the interest deduction to interest paid or incurred in business and the excess of other interest paid in excess of tax-exempt interest received, but the Senate reinserted the 1924 Act provision. There has never been any other attempt to limit the interest deduction to interest paid or incurred for a business purpose.

The intent of Congress with respect to interest on annuity loans is also clear. The Revenue Act of 1932 specifically denied a deduction for interest "on indebtedness incurred or continued in connection with the purchasing or carrying of an annuity". However, in the 1934 Act, the provision denying an interest deduction on indebtedness incurred or continued in connection with the purchasing or carrying of an annuity was eliminated. The reason for this change in the 1934 Act is set forth in S. Rep. No. 558, 73d Cong., 2d Sess. 24 (1934), as follows:

> "The existing law also prohibits the deduction with respect to interest paid or accrued on indebtedness incurred or continued to purchase or carry an annuity. The House Bill enlarges this prohibition to apply if the proceeds of the indebtedness are actually used in purchasing or carrying an annuity. The theory for not allowing the deduction in such cases is that, since the annuitant was not required to report annuity payments as income (until they exceeded his capital investment), he ought not to be permitted to reduce his taxable income by the allowance of such a deduction. However, since the annuitant is required under the bill to include in income a certain part of the annuity payment received each year, your committee is of the opinion